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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1940

No. 699

GILBERT MOODY, JAMES H. JORDAN and WALTER J. SELBY,
Petitioners,

vs.

JAMES IRRIGATION DISTRICT, Debtor,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit
and
BRIEF IN SUPPORT THEREOF.

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No.

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Petitioners,

vs.

JAMES IRRIGATION DISTRICT, Debtor,
Respondent.

PETITION FOR WRIT OF CERTIORARI to the United States Circuit Court of Appeals for the Ninth Circuit.

To the Honorable Charles Evans Hughes, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

Petitioners pray that a writ of certiorari issue to review the decision (R. 135) of the Circuit Court of Appeals for the Ninth Circuit made in the above entitled cause on September 5, 1940, which affirms the

interlocutory decree of the District Court for the Southern District of California, Northern Division, rendered against Petitioners on June 14, 1939. (R. 88.)

OPINIONS BELOW.

Opinion of Trial Court, 25 Fed. Sup. 974;

Opinion of the Circuit Court of Appeals, 114 Fed. (2d) 685.

JURISDICTION.

The decision of the Circuit Court of Appeals was rendered September 5, 1940. (R. 135.) A Petition for Rehearing was filed October 4th, 1940 (R. 136) and denied October 15, 1940. (R. 136.) The mandate was stayed until disposition of the case by this Court. (R. 136.) The Jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code. (28 U.S.C., Paragraph 347(a).)

STATUTES INVOLVED.

Municipal Bankruptcy Act of May 24, 1934, c. 345 (48 Stat. 798) 11 U.S.C. 301-303, adding Sections 78-80 to the Bankruptcy Act of 1898; Act of August 16, 1937, c. 657 (50 Stat. 654) 11 U.S.C. 401-404, adding Sections 81-84; and Act of June 22, 1938, c. 575, Sec. 3(b) (52 Stat. 940). Principal

California statutes involved are "the California Irrigation District Act", Stat. 1897, P. 254 as amended; the "California Districts Securities Commission Act", Stat. 1931, P. 2263 as amended, and Stat. 1917, P. 243 as amended.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

This is a proceeding brought by the respondent James Irrigation District, a California Irrigation District, for readjustment of its debts under what is now Chapter IX of the Bankruptcy Act of 1898, as amended. (11 U.S.C. Sec. 401-404.)

The matter came on before the court for hearing on November 28, 1938, on the Petition filed by the James Irrigation District, hereinafter called the district, on December 7, 1937, and the Answer and Objections to the Plan of Composition.

The district was organized February 6, 1920, pursuant to the California Irrigation District Act (Cal. Stats. 1897, P. 254, as amended), and has a gross area of 24,390 acres situated in Fresno County, California. (R. 5.) It issued general obligation coupon bonds in the amount of one million dollars May 16, 1920. All of these bonds were outstanding at the time of the hearing except five bonds of $1000 each. The plan of composition proposed disposition of these bonds as well as $21,954.75 of unpaid warrants. (R. 5, 6.)

Prior to the filing of the petition the district had acquired, pursuant to tax process, title to all of the

land within the district except 114.33 acres. (R. 19, 55, 77.)

17,630 acres of the land within this district is also within Reclamation District No. 1606 which was organized in 1914 under the provisions of the Political Code of California, and is also a public corporation. This Reclamation District had $445,000 in bonds outstanding which were secured by an assessment upon the lands within that Reclamation District. (R. 7.) This bond issue was also seriously in default and the County Treasurer had taken title to nearly all the land within the Reclamation District as trustee for the bondholders. Also the bulk of the land in the district had been sold and deeded to the State of California for non-payment of delinquent county taxes.

A settlement had been made with the county involved as to its tax title and the title of the county was acquired by the irrigation district at about the time of the hearing. (R. 19.)

The plan of composition offered a settlement of 24.976¢ for each dollar principal of the Irrigation District indebtedness but had a contingent provision requiring that the bonded indebtedness of the Reclamation District should also be settled and compromised out of the funds to be paid to the Irrigation District bondholders (R. 70-77), so that the net amount offered by the plan to the Irrigation District bondholders was 18.80¢ for each dollar of principal. The plan provided that the money to be paid to the Reclamation District should be paid to the Irrigation

District. This indebtedness has all been liquidated we contend and it is conceded that the title to all lands, except the 114.33 acres, is vested free and clear of encumbrance in the Irrigation District.

The bulk of the bonds of both districts were held by the James Land Corporation, which was a private corporation, and it was the principal and substantially sole creditor consenting to the plan of composition.

The money to be paid as provided by the plan of composition was obtained from a loan granted by the Reconstruction Finance Corporation, hereinafter referred to as the R.F.C., in the sum of $256,500. (R. 20.)

Only the petitioners resisted the plan of composition, and owned respectively, Moody, $3000, Jordan, $7000, Selby, $9000, principal amount of bonds. These creditors filed objections grounded upon the unfairness of the plan, contending amongst other things that the district owned all of its property in trust for the creditors and that purchasers of land will benefit unduly at the expense of the creditors; that the plan of composition has been executed, the debt readjusted to an amount of over 90 per cent of its former indebtedness, charging also lack of good faith, discrimination against the answering creditors; that the bonds of the James Land Corporation have been cancelled, surrendered; that the Bankruptcy Statute cannot be made to apply to this district and that the answering creditors were entitled to separate classification and are secured by certain trust funds.

Our view of the case.

A loan from the R.F.C. was obtained under the provisions of Tit. 43, Sec. 403, U.S.C., and disbursement was made on that loan after the filing of the bankruptcy petition prior to the hearing. The bonds of the accepting creditors were delivered by them to the R.F.C. after the petition was filed upon disbursal of the R.F.C. loan. The R.F.C. filed a claim on these bonds, stating that the R.F.C. "holds" the securities but did not state that it "owns" the securities. Now these bonds of course were for the most part those held by the James Land Corporation and the deputy treasurer of the district testified upon examination by the court and by counsel that none of the matured bonds or coupons held or owned by the James Land Corporation or the R.F.C. had ever been presented to the treasurer for payment since the year 1929 (R. 18), and he had no knowledge of the matter before that date. The R.F.C. claim set forth the face of all of the bonds and the matured coupons and did not make any claim that any of the matured bonds or coupons had ever been presented to the treasurer of the district for payment or that any of them had ever been registered as not paid for lack of funds. (R. 18.)

The importance of this point is that Sec. 52 of the California Irrigation District Act provides that the treasurer of the district must pay the matured claims against the district out of the bond funds in the order in what they are presented to him for payment.

Section 52 provides:

> "Upon presentation of any matured bond of the district, the treasurer shall pay the same from

the bond principal fund, and upon presentation of any matured interest coupon of any bond of the district, the treasurer shall pay the same from the bond interest fund. If money is not available in the fund designated for the payment of any such matured bond or interest coupon, it shall draw interest at the rate of seven per cent per annum from the date of its presentation for payment until notice is given that funds are available for its payment, and it shall be stamped and provision made for its payment as in the case of a warrant for the payment of which funds are not available on its presentation."

Cal. Stat. 1931, P. 172.

If funds are not available, the matured claims are registered by the treasurer and subsequently paid in the order of presentation. And the courts of California have so construed this section. (*Bates v. McHenry,* 123 Cal. App. 81; *Shouse v. Quinley,* 3 Cal. (2d) 357.) The only matured bonds and coupons which have been presented to the treasurer in accordance with Sec. 52 are Moody, $3260, Jordan, $3910, and Selby, $4600. (R. 14-17.) (See Court's Findings, R. 82-85.) In each case 7 per cent interest is payable on these amounts from day of presentation. The approximate total claims of the objecting creditors is $30,000. In the financial statement of the district for 1938 was an item of $30,000 under the heading of "Suspended Credits." (R. 53.) It was explained that this was an amount put on deposit in Federal Reserve Bank required by the 5th paragraph of petitioner's exhibit 19 which was a letter from the R.F.C. to the Bank relative to disbursal of the loan. (R. 53, 37.) Counsel

for the district stated that there was some correspondence and conversation about this matter in which it was suggested that in view of the fact that there were outstanding $30,000 in Irrigation District Bonds, a like amount in Reclamation District Bonds, that there should be "some guarantee that if the district had to meet these obligations there would be something on hand to meet them. The court and counsel for the district remarked that this was undoubtedly what the deposit was for." (R. 54.) The financial statement for 1938 showed the further item of a total of $68,890.66 in the funds of the district. (R. 54.) Of this amount, the item in the reserve fund and the bond fund totalling $12,597.30 and some portions of the general funds are trust funds belonging to the petitioners, who have presented their claims and are next in line for payment. (Findings, R. 85.)

The petitioners contend that they are entitled to separate classification as to those claims which were presented to the treasurer and by the treasurer stamped and registered. This case is peculiar in that out of a bonded indebtedness of over a million dollars, of which a half million has already matured, with a further half million in defaulted interest coupons (R. 55), a portion of the claim of the petitioners amounting to approximately $11,770 plus interest thereon, is entitled to separate classification by reason of having been presented to the treasurer of the district for payment in accordance with the provisions of the California law on the subject. It is the contention of these petitioners that the $30,000 deposited with the R.F.C. as well as something over $12,579.30

of moneys in the bond funds, and other funds, constitute trust funds which cannot be applied pro rata until the preferred claims of the petitioners have been paid in full with 7 per cent interest. If the plan is otherwise fair, if our other contentions are not good, then the plan might be confirmed upon condition that these preferred claims of the petitioners amounting to $11,770 plus interest at 7 per cent be paid in full.

The "Plan" required the bondholders to pay to the district enough money to acquire all the reclamation bonds. (R. 8, 9.) The R.F.C. therefore holds these bonds in trust for the district. The original creditors consisting chiefly of the James Land Corporation and A. L. Cowell retained no interest in the bonds upon the transfer of their bonds to the R.F.C.

In this case the district has acquired marketable title to all the land of the district (except a minuscule of 114.33 acres, possibly held by the directors to give them a legal position as district directors). Since this district is a state agency and the property is the property of the state (*El Camino Irrigation District v. El Camino Land Corporation,* 12 Cal. (2d) 378), it seems apparent that the state is not only the owner of the assets but also becomes in a peculiar sense the debtor on the bonds.

Under California law the new refunding bond issue cannot be issued except that bond issue be less than 60 per cent of the value of the bare land in the district plus the district's works.

> "Sec. 4. * * * No bond issue of any district shall be approved for certification as provided in this act which together with any other outstanding

> bonds of such district including bonds authorized but not sold exceeds sixty per centum of the aggregate value of the water, water rights, canals, reservoirs, reservoir sites, irrigation and power works and other property owned by the district or to be acquired or constructed with proceeds of the bonds proposed to be issued by said district, and the reasonable value of the lands within the boundary of the district."
>
> *Cal. Stat.* 1931, P. 2263.

Therefore, there is a beneficial interest in the land equal at least to 40 per cent of the value of the district's assets. That land is not offered to the bondholders. It does not seem that it could be taken from them under the guise of a bankruptcy proceeding. It does not appear either that the bankruptcy statute can apply to the state, as the state owns all of the assets and is in substance the debtor.

Petitioners in this case do not contend that if the land were owned by private land owners, those landowners could reasonably be expected to pay the entire debt of the district. But they do contend that the State of California cannot thus repudiate its own obligation as maker of the bonds and owner of the lands. We further contend that in no event can the creditors be deprived of the equitable interest in the land over and above the R.F.C. loan; further, that petitioners' preferred claims must be paid in full.

QUESTIONS PRESENTED.

1. When the local law provides that the obligations of the district shall be paid in the order of their presentation to the treasurer after maturity and the petitioners are the only creditors who ever presented any of their matured claims to the treasurer and they have made proof of their claims and the bankruptcy court so finds, are such claims given a "preference as provided by law" as defined in the statute, and must they be separately classified?

2. Where the district owns all the land and it has been cleared of other tax liens and obligations and the local law provides that it cannot borrow more than 60 per cent of the value of the bare land, without improvements, plus the value of the works of the district, and the plan of composition only offers to the bondholders the amount which it can thus borrow, as a matter of law can such a plan be fair, and should not the plan to be fair give to the bondholders not only what the district can borrow but the land itself?

3. Where under local law it has been determined that all of the functions of bankrupt are exclusively governmental, can an interlocutory decree be valid which applies to such a district?

4. Where the local law determines that the assets of the district are state property and the bonds which are the subject of the composition plan are issued by the state, although payable solely by the district out of its assets, can the state consent to a plan of composition which will thus terminate its (limited) liability?

5. May not the State be prohibited by its own Constitution from consenting to bankruptcy relief? Do provisions against surrender of taxing power, impair-

ment of contracts, delegation of judicial authority, confiscation of private property prohibit such consent?

6. Where a corporation creditor owning over 90 per cent of the district's bonds consents to the plan, and the R.F.C. has paid off that corporation at the composition rate, has not the indebtedness of the district been thereby reduced automatically, in view of Title 43, sec. 403, U.S.C., providing that the R.F.C. cannot make a loan unless it is satisfied that such loan will result in a substantial reduction of the indebtedness of the district?

REASONS FOR GRANTING WRIT OF CERTIORARI.

(1) The law of California provides, we contend, that the matured claims of a California irrigation district must be paid in the order in which they are presented to the treasurer of the district, stamped and registered by him. In this case, the only claims which were ever so presented and stamped are approximately $11,770 in claims of the petitioners out of a total indebtedness of over a million dollars. We contend, therefore, that the court below erred in holding that this is not a "preference" provided by law as defined in Chapter IX of the Bankruptcy Act, and erred in holding that the Bankruptcy Law supersedes the local law on this question; and erred in holding that because a recognition of this local law might upset or interfere with some bankruptcy plan if applied, such a law should not be applied in a bankruptcy court. This is a question which may come before courts many times; is one of importance, and this Court should

grant a review of this case in order to set at rest the question of construction of the term "preference" in the application of the municipal bankruptcy law.

2. When the local law provides that bonds cannot be issued against the lands of the district in excess of 60 per cent of the value of the bare lands (without improvements) and of the works of the district, this Court should determine, as we contend, that as a matter of law a plan of composition is not fair which only offers the amount which can be obtained by such a loan.

3. Where, as here, the district owns all the land, the plan should offer the land to the bondholder, the creditor, as well the amount it can obtain from the R.F.C. upon such a restricted loan. We contend that in considering a plan of composition under the municipal bankruptcy law, the principles confirmed in *Case v. Los Angeles Lumber Products Company,* 308 U. S. 106, must be applied to a public agency, and this Court should so determine, and this is a matter of administration of the act which should be settled by this Court.

4. Where the district owns all the land and it is determined by state law that such land becomes state property, this Court should determine, as we contend, that the state can not give its consent to the bankruptcy plan where it thus becomes not only the debtor but the creditor? This is a matter of great public importance because of the effect of such a determination upon matters of public law, as affecting the question of dual sovereignty.

5. Where as here property is held in a public trust we contend the bankruptcy power can not be applied to such trust and this Court should so determine.

6. Where the R.F.C. has paid off the principal consenting creditor, the plan is an executed plan. The creditor has surrendered his claims. The R.F.C. was authorized by its basic charter (43 U.S.C. 403) to loan, if satisfied that a substantial reduction is thereby effected in the district's debt. We contend the plan then becomes executed as to such creditor and that this Court should so determine.

Wherefore, petitioners pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that Court to certify and to send to this Court for its review and determination a full and complete transcript of the record and of the proceedings of said Court in the case numbered and entitled in its dockets as "No. 9353, Gilbert Moody, James H. Jordan and Walter J. Selby, Appellants, vs. James Irrigation District, Debtor, Appellee", and that the decree of said Court be reversed by this Court with directions to dismiss the bill, and for such other relief as to this Court may seem proper.

Dated, Turlock, California,
January 6, 1941.

GILBERT MOODY,
JAMES H. JORDAN,
WALTER J. SELBY,
Petitioners.

W. COBURN COOK,
Counsel for Petitioners.